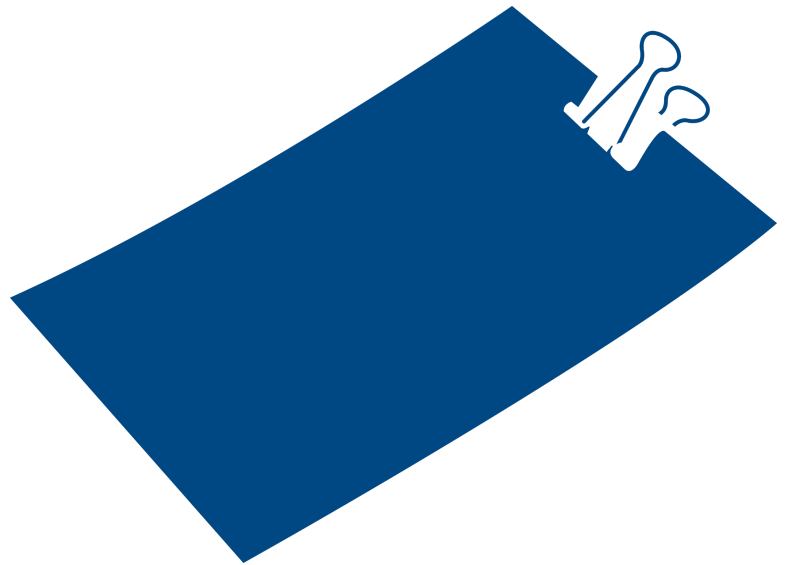


Citizens Advice response to Ofgem's Supplier Licensing Review: Credit balance protections



Summary

In recent years, supplier failures have affected nearly 2 million consumers and left behind costs of over £300 million¹. Ofgem have approved costs of over £60 million via the Last Resort Supplier Payment Claims levy, nearly £50 million of which have been approved to cover credit balance refunds². These costs are mutualised across all suppliers and are directly increasing the prices paid by consumers.

Citizens Advice have been calling for Ofgem and the Government to take action since 2013³. We therefore welcome Ofgem's proposals to address the costs mutualised as a result of large credit balances when suppliers fail and to mitigate the risk of high credit balances for consumers.

We broadly agree that the proposed changes can help reduce the cost of mutualisation and will require suppliers to pay a fair share towards any additional risk their activities create. The changes should also incentivise suppliers to run their business more responsibly and mean that suppliers are less likely to hold customer credit balances which are larger than necessary.

However, we think that the proposals must also be able to take account of consumer preferences. In particular, we think the auto-refund proposals could be amended to enable consumers to choose to keep some amount of credit balance at the end of the year to mitigate against future price or usage increases.

Ofgem should ensure that, in implementing these proposals, they account for other relevant legislation and regulations. For example, Ofgem should consider how they will monitor the credit balance protection proposals alongside the recently implemented Financial Responsibility Principle. Similarly, changes being implemented by the government relating to the Renewables Obligation should also be considered as the new rules are implemented. It will be crucial for Ofgem to monitor the credit balance protection policies alongside existing regulations and to ensure there is swift enforcement action for suppliers who

¹ Based on [Picking up the Pieces](#) and costs of recent supplier failures.

² These costs are taken from Ofgem's published decisions on Last Resort Supplier Payment Claims - this data is only available for suppliers that failed between November 2016 and August 2019. 10 suppliers have failed between September 2019 and January 2021 for whom claim data is not available.

³ For example, in private correspondence to Ofgem from Consumer Futures (17th October 2013 & 29th November 2013), our response to Ofgem's Draft Forward Work Programme 2017/18 (2017), and our Utility Week blog (2018).

are not complying, in order to minimize consumer detriment and reduce mutualised costs when suppliers fail.

Finally, in 2019 we estimated that Renewables Obligations (RO) costs mutualised across consumers are about twice as high as those incurred by the Last Resort Supplier Payments⁴. We called for reduced costs of mutualisation, including via legislative changes to require the bills for the Renewables Obligation to be paid more frequently. We continue to call for action in this area to achieve the aims of the supplier licensing review.

Response

Q1: Do you agree with our objectives set out in chapter 1?

Citizens Advice agrees with the objectives set out in the consultation. However we think that an additional objective should be to:

- maintain some consumer choice over how to manage credit balances, while achieving these objectives

In addition to the costs that are mutualised following a supplier failure, irresponsible business practices put customers at risk of detriment and negative outcomes while their supplier is still active.

Setting out measures that require suppliers to protect credit balances would minimise the costs of mutualisation faced by consumers and other actors in the market, and could indirectly promote more responsible business practices in the GB energy retail market that can improve the consumer experience (for example, having a threshold on how much credit suppliers can hold may encourage them to more promptly refund consumers excess balances upon request). We also agree with the objective of ensuring that regulatory costs do not hamper good practice or stifle innovation that would benefit consumers in the energy retail market.

While this consultation relates to credit balances we believe that these objectives should apply across all costs that suppliers leave behind when they exit the market - including costs of unpaid Renewables Obligations (ROs) and other industry schemes.

⁴ Costs based on supplier failures in 2018 and 2019 were estimated to be £97 million for unpaid ROs, and £47 million for Last Resort Supplier Payments.

Additionally, the current objectives are only related to domestic energy consumers. Throughout the supplier licensing review consultations, Citizens Advice has been calling for improvements for microbusiness consumers, including credit balance protections.

Q2: Do you agree that our proposals meet our objectives as set out in chapter 1? Please provide views on both our autorefund and threshold proposals and any alternatives you consider that meet our objectives that Ofgem should assess.

We agree that the proposals generally meet Ofgem's objectives.

We believe that the proposals will mostly contribute to the objective of ensuring that suppliers bear an appropriate share of the cost of mutualisation risk they pose to the market. Suppliers who operate models that may involve holding larger credit balances will be required to take more steps to protect those balances in the event of failure. The proposals may lead suppliers to engage in more responsible business practices (for example by financially incentivizing them to assess direct debits more regularly, to take further steps to get accurate meter readings from their customers, and to promptly refund customers excess credit upon request).

We do not have access to data about the specific costs suppliers will incur to implement these proposals. But we agree with Ofgem's assessment that the proposals should impose only minimal costs on suppliers already following best practice while achieving the expected benefits for consumers.

In order for these proposals to meet the objectives set out, it will be necessary for Ofgem to effectively monitor and take action against suppliers not abiding by the regulations. We also recognise there are already some relevant rules in this area. As Ofgem sets out in the consultation, suppliers are required to "refund credit when a consumer requests it, unless it is fair and reasonable for them not to". Despite this, the Citizens Advice consumer service regularly hears from consumers who are struggling to receive a credit refund, often with no justification from the supplier. One benefit of these new proposals could be that the onus will move to suppliers to demonstrate that they are only holding appropriate levels of credit balances in order to avoid the costs of protecting credits above the threshold.

Regarding the autorefund proposal specifically, we think that while it may help to meet the objectives that Ofgem set out, changes should be made to reflect

consumer preferences and enable some consumer choice. We know from previous voluntary 'auto-refund' policies by suppliers that some consumers prefer to maintain a reasonable credit balance to offset future increased energy consumption or an increase in their tariff.

We think this could be taken into account by setting the threshold for autorefunds above zero, and enabling consumers to opt-in to a full refund below this level. This would tackle the problem of inappropriately high balances, while mitigating some of the risks of autorefunding credit which later has to be clawed back if a customer has not submitted a recent meter reading and their use was higher than estimated. It could also be more efficient, by removing the need to refund very small credit balances.

We elaborate on this further in our response to question 4.

Q3: Do you agree that our draft Standard Licence Conditions reflect our policy intent?

Yes, we agree that the draft Standard Licence Conditions (SLCs) reflect your policy intent. However, we are listing below some components of the draft SLCs which can be made clearer:

- 27.15B.2 - Ofgem should clarify when the relevant Domestic Supply contract is considered to begin, for example whether a customer should be autorefunded every 12 months from when they first join a supplier, or if this start date is reset when they move to a new tariff with the same supplier
- 72.15B.3 - This draft licence condition states that: "Credit is to be calculated for the preceding calendar year". We believe this should be revised to state that credit is to be calculated for the previous 12 months, to account for consumers starting their payments at different points of a calendar year.

We will consider the draft licence conditions in further detail at the statutory consultation stage.

Q4: Do you agree that autorefund of credit balances above £0 at the end of 12 months should not be tied to receiving a meter reading from the customer?

We believe there are benefits to requiring that customer credit is autorefunded regardless of whether a meter reading has been received, however this could pose some risks if the credit balance limit at the end of 12 months is set to £0. This is because at a later point once a reading is provided the consumer could owe money to the supplier if their usage is higher than the estimated amount. However, we generally expect that suppliers should have issued at least one accurate bill to each customer for energy consumed in order to remain compliant with their licence requirements.⁵

Requiring autorefunding of credit balances regardless of whether a meter reading has been received should further encourage suppliers to more regularly issue communications requesting meter readings, or send a meter reader. As a result, it might prompt suppliers to more regularly update their customers' direct debits, as well as promptly refund credit upon request. Between 1 April 2020 to 31 March 2021 the Citizens Advice consumer service received an average of just over 100 cases per month relating to customers whose supplier is failing to refund their credit. We regularly see examples in these cases of customers trying to get back over £1000 of credit, with some cases of customers trying to get back several thousand (including over £5000) of credit (see Case Study 1).

Case Study 1

In December 2020, Jason contacted the Citizens Advice consumer service. He had sent an email to his supplier requesting information in regards to a refund. Jason has £5030 in credit on his account and it shows that he has an available refund of £280. He tried calling his supplier but couldn't get through. Jason's direct debit is £270 per month for his 1-bedroom flat, but his smart meter shows that he only used £10 - £15 of electricity per week in the winter.

While existing rules require suppliers to refund credit when a consumer requests it⁶, in order for customers to benefit from the current regulation, many need to raise a complaint with their supplier and subsequently take the complaint to the Energy Ombudsman 8 weeks later. This process can be time consuming, and especially frustrating in cases where customers urgently need their credit back. The autorefund policies can prevent the issue of large amounts of credit accruing over several years.

⁵ SLC 21B and 21BA

⁶ SLC 27.16

However, as set out in question 2, we also know that some consumers prefer to keep a credit balance as a buffer in case of higher costs in future, which is more likely where an accurate bill has not been provided recently.

We think Ofgem should consider setting the threshold for autorefund above zero in order to mitigate the risks of consumers facing a higher bill or increased direct debit later on as a result of them not having submitted an accurate meter reading recently. Consumers could be offered the option of a full refund below the threshold if they want one and if they submit a meter reading. The exact level of the threshold should be based on an assessment by Ofgem of a reasonable amount of credit for most customers, and could be reduced over time as the smart meter rollout improves the accuracy of bills.

Q5: Do you agree that suppliers operating a payment in advance business model should face the cost of the risk they pose to the market?

We agree that suppliers operating a payment in advance business model should face the cost of the risk they pose to the market. The current proposals still allow for these models to operate. However, the companies that are benefiting from the working capital provided by payment in advance models should be the ones to bear the cost of protecting that capital, rather than risking that the cost is mutualised across the market should that supplier fail.

We believe that the proposals are likely to mean that suppliers who operate business models which lead to higher credit balances across their portfolio will be more likely to face costs related to protecting credit above the threshold. This also includes models that offer credit for new customer referrals. This has been popular with some consumers, and may be able to continue under the new rules if consumers receive cashback or vouchers which can't be mutualised, instead of credit.

Q6: Do you agree with the obligation and compliance approach for thresholds as outlined?

We agree with the approach to require a regular obligation on suppliers to put in place systems to demonstrate compliance with different thresholds throughout the year. This would create an opportunity for Ofgem to intervene early when a supplier breaches the credit balance limit.

Monthly thresholds may allow Ofgem more opportunity to identify any issues early. Setting a milestone threshold for key times when credit is expected to peak could mean that if a supplier is not complying with their obligation, Ofgem might not be able to address it in time and the supplier could fail with a large amount of accumulated credit balances.

We also agree with Ofgem's proposal to take a risk based approach to assessing compliance (i.e. accessing and reviewing compliance data), as has been done with previous consultations during the Supplier Licensing Review.

Q7: Do you agree that there should be tolerances around the threshold and how do you consider these should be set?

Yes, we agree that there should be tolerances set around the threshold so that suppliers do not need to incur large costs and administrative burden to protect small amounts of credit that fall above the threshold.

When determining how these tolerances should be set, Ofgem should examine practices applied by various energy codes, or the administrative threshold applied in the Renewables Obligation to avoid mutualisation bills for very small sums. The tolerances should be set at a level that avoids the risk of suppliers incurring high costs to protect a low amount.

Q8: For suppliers: For your fixed direct debit customers, what is the average percentage difference between estimated annual bills and actual annual bills for those accounts that ended with a positive credit balance?

n/a

Q9: Please provide your view on the credit balance threshold model published alongside this consultation. Do you agree:

- With the methodology we have used to calculate surplus credit balances in our draft threshold model?
- That our threshold needs to reflect that consumers who start at different points of the year have different credit balance requirements?

- That our model methodology accounts for the impact of contract start date on our threshold?

We agree with the credit balance threshold model and agree that the threshold needs to reflect that consumers who start at different points of the year have different credit balance requirements.

We also agree that the model accounts for the fact that suppliers will pick up customers at different times of year after the first year of the policy being implemented. This is because the requirement to refund balances on a customer's 12 month anniversary should see those refunds spread across the year in a pattern that (a year in arrears) reflects the supplier's acquisition patterns.

Q10: Do you agree that these measures should apply only to domestic consumers?

Throughout the supplier licensing review, Citizens Advice has been calling for a safety net for credit balances of microbusiness consumers - paid for by other non-domestic consumers. We have also called on Ofgem to:

- take action to reduce the size of microbusiness credit balances, so that less money is put at risk if a supplier fails. This could include credit protection measures like those discussed in the consultation.
- extend requirements for suppliers to refund domestic customers on request to microbusiness customers.

Our research has previously highlighted⁷ that supplier failures can leave microbusinesses thousands of pounds out of pocket. Many microbusinesses are on contracts which they cannot easily leave, even if they know that their supplier might be at risk of failure. Also, suppliers are not obligated to return a credit balance if the microbusiness requests it, and there is no easy way for a microbusiness to have their security deposit returned.

Recent research⁸ has found that microbusiness owners can be unsure if they're in credit or not, and that their views on credit balances varied. While the majority of businesses felt positively about having a credit balance, some smaller businesses felt that they needed access to the cash being held by their supplier to fund more pressing costs. Due to reduced energy usage because of COVID-19,

⁷ Citizens Advice. [Closing the protection gap](#). 2019

⁸ Forthcoming research by Blue Marble Research for Ofgem and Citizens Advice (2021).

several businesses had built up significant credit balances, some exceeding £1000. Many business owners were not clear what the consequences of their supplier failing would be on their credit balances, and several people believed that their credit would be protected or insured.

While we agree that the specific measures set out should apply to domestic consumers only, Ofgem should urgently set out equivalent measures to ensure that microbusiness consumers are able to request back excess credit. This would improve outcomes for individual consumers, and would limit the costs mutualised across the market when energy companies fail and the supplier of last resort opts to protect microbusiness credit balances.

Q11: Do you agree with the proposed implementation timings?

When considering the timing for implementing these proposals, Ofgem should consider alignment with other industry changes. For example, the Warm Home Discount reforms might affect credit balances and may need to be considered in the implementation of these policies. Ofgem should also consider changes to the RO mutualisation threshold and related legislation, which may affect the total costs suppliers are likely to face at the time of these policies being implemented. We note that the RO changes will reduce the costs paid by suppliers, which may offset any higher costs that result from the need to protect credit balances.

Q12: Do you agree with our assessment of the costs and benefits of our proposals as set out in chapter 5 and appendix 1?

We generally agree with Ofgem's assessment of costs and benefits based on supplier responses to the RFI. As Ofgem sets out, key benefits of the proposals include that the amount of credit balance at risk of mutualisation will be reduced, but also that money which is not required to meet energy costs will be returned to consumers. As set out above, we believe that the policy needs to balance this benefit alongside the benefit of enabling consumers to choose how they pay for their energy in a way that works for them.

As acknowledged in Ofgem's consultation, "suppliers will face some implementation costs from changing billing systems to identify surplus credit balances". Suppliers may also face costs associated with changing communications so that customers understand why they will be refunded credit, or with adequately resourcing their customer service teams to ensure that

consumers who get in contact with questions about the changed policy can receive replies. However, we agree that some of these costs are unlikely to be as high for suppliers who already have systems in place to control credit balances. The level of contact that suppliers can expect to receive will also depend on how the credit balance limit at the end of 12 months is set. For example, customers may be more likely to contact their supplier if they see that their credit balance is 0, whereas being refunded any money above a higher threshold may drive less contact.

In the consultation, Ofgem does not acknowledge an impact on the incentives to suppliers to offer a fixed direct debit model. The proposed changes may make fixed direct debit payment models less attractive to suppliers if they become more costly due to suppliers needing to protect credit above the threshold, given that suppliers will not be able to recover debts to £0 every 12 months in the same way that they'd be obliged to repay credits or if suppliers are not able to use credit surpluses to finance their activities.

It is also important for Ofgem to account for the latest available costs data when calculating the costs and benefits of the proposals. Based on credit balance costs claimed through the Last Resort Supplier Payment Claims (LRSP) levy, approximately £33.5 million of credits balances were claimed by SoLRs of companies that failed in 2018, whereas only £4.1 million were claimed by SoLRs of companies that failed in 2019⁹. Fewer suppliers made claims on the LRSP levy in 2019 than 2018, and claims were generally lower, despite more customers being affected by SoLRs in 2019 (approximately 690k) than 2018 (approximately 540k). It is possible that suppliers which hold lower credit balances upon failure attract more competitive SoLR bids, including offers from the bidding SoLRs to not claim on the Last Resort Supplier Payment levy. Citizens Advice doesn't have oversight of the credit balances at point of failure where the SoLR did not claim on the levy, and therefore cannot confirm whether this is the case. However it is important for Ofgem to consider how evidence of costs from recent supplier failures might affect the indirect financial costs and benefits of these proposals.

Q13: What implementation costs do you think suppliers will incur should we progress both our autorefund and thresholds proposals?

⁹ Based on: costs claimed in 2018 by Cooperative Energy for Iresa Energy's failure, by Shell Energy for Usio Energy's failure, by Scottish Power for Extra Energy's failure, by OVO Energy for Spark Energy's failure, and by Together Energy for One Select's failure, and costs claimed in 2019 by OVO/SSE for Brilliant Energy's failure, by SSE for Cardiff Energy Supply Limited's failure, by EDF for Solarplicity's failure. Costs claimed by British Gas for Breeze Energy's failure are not yet published.

Please detail both the category of cost as well as your estimation of cost figures.

n/a

Q14: Do you agree:

- We should account for cost of suppliers using parent company guarantees in our assessment of working capital
- With our approach to applying the cost of third party guarantees to surplus credit balances

We agree with Ofgem's approach to accounting for costs.

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